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**THE DIRECTOR OF CENTRAL INTELLIGENCE**

WASHINGTON, D.C. 20505

Executive Registry

74-6088/A

NSC review completed - may be declassified in full

4 November 1974

Mr. Leo Cherne  
President's Foreign Intelligence Advisory Board  
The White House  
Washington, D. C.

Dear Mr. Cherne:

Thank you so very much for your letter of 25 October with its most fascinating and challenging attachment. Your words about the Intelligence Community were certainly appreciated, but I hasten to indicate that the real praise does not go to me but to the people in it who did the actual work. I agree entirely, however, with your comment that we are running very hard simply to keep up; in fact, I think we are falling behind despite our running. I do think that the stimulus which you personally provided, as well as what was pushed by the Board earlier, has been of enormous value to us and has helped us to get up to the speed we are at.

You will be interested in the attached memorandum that I sent to my associates on this matter indicating that we really have a lot to do to move ahead. In that regard, you will also note that I asked them for a specific set of agenda items around which we might organize a discussion with you and the principal figures in the Intelligence Community. I will ensure that they receive a copy of your remarks beforehand and thereby hope to focus our discussion on the most useful steps.

We are making some progress on reconstituting the Resources Advisory Board, and I think this will be a particularly fruitful tool in this area. Nonetheless, the real proof of the pudding is going to be in what we produce, and I especially welcome your suggestions of specific substantive questions needing attention. My real problem will be to determine whether we have adequate analyst talent for the challenge ahead and, if not, where I am going to find the personnel resources needed. Part can be overcome by better interaction of the talent now in the various agencies and departments, and I think that shall be my first objective.

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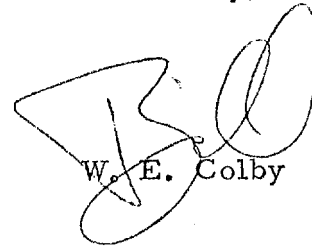
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As you know, I also will be distributing our Economic Action Plan, which I gather you thought made a certain amount of sense. I have deliberately required that I include comments on our performance thereon in our next annual report, in order to ensure follow-up.

Again, please let me thank you for your interest, your impressive contribution of knowledge, experience and imagination, and your positive remarks about the Community.

Sincerely,



W. E. Colby

Attachment

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MEMORANDUM FOR: Mr. Proctor *Hold for meeting w/ DC I*

At a morning meeting soon, Colby wants to discuss a program of action in response to Leo Cherne's comments.

OER would presumably take the action on points 2b, c, and e and consult with  on 2f.

Perhaps OCI, as editors-in-chief of the daily and weekly pubs, should be made aware of 2e.

Should OER get started on any of this or wait until you've talked to Colby?

Do you want OER informal comments *for your* talk with Colby? *Yes* ☒ *No* ☐ *copy.*

Should I send an info copy to Maurice Ernst and ask him to stand by for further instructions?

Yes  No   5 November 1974 (DATE)

FORM NO. 101 REPLACES FORM 10-10 WHICH MAY BE USED. 1 AUG 54 (47)

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*See Chernie*



*Executive Director*  
*The Research Institute of America, Inc.*  
*589 Fifth Avenue, New York, N.Y. 10017*  
October 25, 1974

The Honorable William E. Colby  
Director  
Central Intelligence Agency  
Washington, D.C. 20505

Dear Mr. Colby:

At the last meeting of the President's Foreign Intelligence Advisory Board, I reported on developments affecting economic intelligence which have occurred since the Board's 1973 report to the President on this subject. I am especially pleased to send an edited transcript of the oral report to you.

I hope I paid adequate tribute to the contribution which has been made by the community, under your direction. The results have been very substantial. At the same time, I think we are all running very hard simply to keep up with critical developments.

*Amen*

I will be delighted to discuss with you or any of your colleagues any questions which are stimulated by the report I am enclosing.

Sincerely,

A large, stylized handwritten signature, likely of the Executive Director, is written over the word "Sincerely,".

Encl.

NSC review completed - and takes no action on document

THE WHITE HOUSE

WASHINGTON

PRESIDENT'S FOREIGN INTELLIGENCE ADVISORY BOARD

Transcribed and Edited Remarks of Mr. Leo Cherne  
During the PFIAB Meeting on 3-4 October 1974

PRECIS

Economic disorders now pose greatest dangers to national security.

Where the Board in December 1971 was indeed prophetic in perceiving that economic intelligence was vital, by last year prophecy was no longer required. I have now reached the conclusion, and it has been echoed elsewhere within the Executive Branch, that there is no other threat to this country's security which holds a candle to the potential now resident in the fields of economic disorder--and I would emphasize there are many fields. I make this claim without minimizing the variety of military and other political dangers which the United States faces. I have previously used the phrase "growing entropy," or chaos, to describe the situation; this has moved with such rapidity as to present this country with dangers of a magnitude which were quite unlike what they were a year ago.

Let me leap ahead for a moment to pinpoint the most immediate and visible source of this entropy. The transformation of the international payments system now taking place is so new and unfamiliar that wide differences exist as to its likely impact. Some experts, particularly members of the banking community, feel that unless oil prices drop sharply, a financial collapse is inevitable without a major restructuring of the financial system. Others are more sanguine and believe that financial markets will be able to accommodate the Arab oil producers' massive accumulation of wealth with only ad hoc adjustments. Since my report of a year ago there has been significant change in the weight of those who are on the more pessimistic side of that proposition.

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## BACKGROUND

### General and specific problems identified a year ago.

One year ago we were dealing with a succession of circumstances on which there had been significant--but still not adequate--improvements since the PFIAB report of 1971. Foremost among the gaps, it was clear that those concerned with the making of economic policy were not receiving warnings of impending crises. It was clear that the quantity of economic intelligence which was being provided was outstripping the user's ability to review that intelligence. It was clear that to improve the character and quality of economic intelligence, analysts must develop closer relationships with the policy makers and that there were some elements within the Executive Branch which had such relationships--for example, Treasury and CIEP. It was also more clear that for the remainder of this decade we would focus less on war and peace, than on economic problems, rivalries and even economic warfare.

Some of the specific problems I identified a year ago were:

1. That user-producer relationships were feeble;
2. That there was inadequate feedback to the community;
3. That disintegration of economic order was developing more quickly than the intelligence community could respond to it;
4. That new instruments, nongovernmental in nature, like multinational corporations and international banks were mushrooming at an enormous rate and were providing new problems in the field of economic intelligence;
5. That it was more and more difficult for American businesses to operate overseas and do so competitively with their foreign counterparts who were being provided assistance--intelligence and otherwise--directly and indirectly by their own governments;
6. That the foreign service officer was not being as helpful as he could be if adequately trained and motivated to provide economic intelligence.

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CONTEMPORARY ACTIONS

Some responses of the Intelligence Community in 1973.

Now let me make some observations about what has happened in this year. Under DCI Colby, there has been an energetic and constructive response. Although I have not reviewed everything which has been produced, I am nonetheless struck by the enormous volume and helpful character of much of the output. For example:

1. The International Petroleum Weekly is making a significant contribution. It is fundamental reporting, but reporting which would not exist but for the intelligence community.
2. The Economic Intelligence Weekly is relatively more analytic in nature but is still inadequate in this respect.
3. The Economic Intelligence Special Supplements which have been issued during the year--the special studies--have been of great importance. Here some of the very best thought and projective analysis has emerged.
4. The DCI has articulated the objectives for the intelligence community and the priorities in the economic area. While these priorities are not quite equal to the problems which have in fact occurred in 1974, this goes more to my earlier point regarding the dynamic character of today's economic situation rather than aiming criticism at the intelligence community.
5. A new economic statistical handbook has been issued in which the information is somewhat more useful than its predecessors. One very significant thing has been done--more of the content has been made unclassified, and in the economic area it has been my position that wherever possible, information be unclassified because otherwise it just simply cannot get to the very wide community of people who must use it and therefore would function ignorant of an important body of material.
6. The Economic Alert Lists, which provide field reporters with current highlights of the needs of the total government economic community, have been refined over the past year and appear to provide an important nexus between overseas collectors and Washington analysts.

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7. An action program has been prepared within the DCI's office to meet the promise of the Director that he would take the necessary steps to assure that economic intelligence needs are much more adequately met. It is a useful document.
8. A pass was made at the implications of trends in world population, food production and climate. This is totally projective and analytical and an excellent piece of research. It is not retrospective as, unfortunately, are so many other intelligence community reports.
9. A number of other useful studies were prepared with valuable help from the intelligence community, but under primary sponsorship of other Executive Branch entities. Two deal with technology transfer and critical imported commodities and are therefore subjects which this Board should urge the DCI to ensure the intelligence community keeps a continuous eye on.

I cannot report on whether there have been improvements in assistance to U.S. business operating overseas by means which do not violate the restraints which exist against providing classified intelligence materials. I was assured that this could be done by laundering the materials through the Commerce Department. I don't know how successful, if at all, this has been.

I am also unable to assess whether FSO reporting on economic affairs has improved in the past year--you will recall that we ascribed inadequacies more to attitudes than to any other impediment.

In summary, I would have to give very high marks to the responsiveness of the community under Bill Colby. But I also say they are running very hard to keep up with yesterday.

#### RETROSPECTION AND PROJECTIONS

##### Where were we a year ago and where are we now?

A year ago the dominant economic intelligence problem to which we addressed ourselves was oil. In addition, we were concerned about technology transfer, the behavior of multinational corporations, and the unresolved problem of targetting intelligence resources against the friendlies--nations like France, which had in certain respects adopted an adversary relationship with us, and nations like Canada, which were not adversary in nature, but so terribly important to the economy of the United States.



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Where are we now? First of all, oil and technology transfer are if anything more significant in the period ahead than they were a year ago. Multinationals, I think, are less of a visible problem. The issue of targetting friendlies has entered an altogether new phase: we may be requiring information not because of their potential hostility, but for our safety and the safety of other allies which may only be secured from the friendlies.

A major, newly perceived problem involves getting an answer to the question, "Where are the petro dollars going?" "Where are the Arab investments going, especially in the United States?" Further, we must become increasingly concerned with the availability of strategic and critical materials and avoid the temptation prompted by inflation to reduce our stockpiles below what is necessary. In this regard, at the Economic Summit conference, I believe it was the President of Kraft Foods who pointed out there were \$7.6 billion worth of strategic materials in the U.S. stockpiles and that 99 of 102 materials could be released without ill effect and thusly relieve inflationary pressures. It was further alleged that under present legislative guidelines only \$1.2 billion can be released.

[redacted] stockpile needs have been reassessed in an OMB study. It is likely that [redacted] comments refer to a joint NSC/CIEP analysis of critical imported commodities which was completed last June. If there is a study which assesses stockpile needs, we would of course desire to have it. STAT  
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Another serious potential derives from possibilities inherent in granting most-favored-nation treatment to the Soviet Union; the pressure we are under because of balance of payments deficits and the general influence of detente can very easily militate not only an increase in trade to be expected from MFN status, but less than adequate concern towards the transfer of high technology. I think it is important that we be as fussy as we can be. We must bear in mind that Kremlinologists are an endangered species--even the New York Times says so. And these analysts are the very ones to help us understand the nuance of change in the USSR.

I think we do not adequately know--again I'm talking in terms of feeding the policy maker--how Germany is managing to--with a higher dependence on oil than we have--how they are managing to achieve an inflation rate half of ours. And not France, Great Britain and Japan. Milton Friedman's answer is simply that the Germans have the discipline and competence to control the supply of money more rigidly than anybody else is able or willing to do. If this is the answer, it is not getting through to those who are concerned with policy.

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I see no alternative, under the pressures which the oil-consuming nations face, to an enormous growth in economic nationalism. This requires absolutely alert economic intelligence. This may sound extreme, and a month ago I would not have said it, but a failure to have it risks world depression. And here we come back to the problem that this intelligence must be acquired from nations with which we are not in otherwise adversary relations. Such "self-protecting" nationalism, trade barriers and our own Smoot-Hawley Act were important catalysts to the economic breakdown of the early 1930's.

As an aside, I want to note one of the really shocking observations I heard at the Economic Summit--that if the United States seeks near total independence in energy, the estimated cost will be between \$750 billion and \$1 trillion. The cost of reducing our current dependence by any substantial percentage may still be as high as \$700 billion. That to me was one of the most depressing of the pieces of information and an astonishing revelation, if true. If my calculation based on CIA figures is correct, the oil-producing nations cut their production 26% at the peak of last winter's boycott. They have already, after restoring production, cut it by 15%. In short they are more than half way to the level of cutback that existed at the time of an explicit boycott, except that now it is less dramatic. I think there is an absolute necessity for advance knowledge of further cutbacks in world oil production as early as is possible. I think it is not realized, for example, that U.S. oil production is currently below September 1973. It had been stated, and I myself participated in a number of conferences which made the point, that the problem in the United States was a problem of price. Well, the price has been increased beyond the September 1973 level; even if it has not been increased as much as the companies here would have wanted. Nevertheless, with the increases, more modest than those which have occurred internationally, U.S. oil production is still less than it was in September 1973.

It is vital that those concerned with policy be provided as much information as possible about the bilateral oil arrangements which are increasing such as the one involving Krupp in Germany and the ones which have been made between France and Iran. Here we are dealing with the friendlies problem in acute form, and the U.S. hard-line on oil makes this more vital.

There are two significant aspects to the problem of where Arab investments are going. We not only need to know what is coming into the United States, but we must know where that money is invested. First, for the disruptive capability this has as a potential. Secondly, because the remedies being talked about to lever the Mideast oil states down in their prices are not very

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forceful; there may very well be no alternative than a credible threat to nationalize Arab properties in the United States. And you can't nationalize something you don't know exists. We appear to be getting some help on this problem from the Inouye-Culver Bill now pending before Congress to require Treasury and Commerce to maintain data on foreign investments in the U. S.

In this regard, within the last six weeks there has been a flurry of capital availabilities rumored of Arab money available to U. S. businesses at 7.6% compound interest or 8% straight interest in blocks of \$50 million or more at terms of five years plus. Now that is very cheap money. Whether rumor or not, I do think this is very important because a lot of businesses are chasing after this money. Of course, it is even more important to determine whether or not this is actually true.

Anxiety about world depression is spreading. That anxiety is not based on business doing badly; it is simply the treat of a breakdown of international mechanisms involving trade and money. With this anxiety the President and those who serve him must know about any imminent or threatening economic nationalism or economic warfare because those are the essential ingredients for this phobia.

I saw an interesting chart [ ] during the weekend of the Economic STAT Summit meetings that tried to correlate the various phases of the previous Administration's plan to consumer and wholesale prices. I decided to try some of the same techniques to determine what effects the wheat deal and the oil situation may have had on consumer and wholesale prices. Each instance, you will note, marks an astonishing rise in these price indices. Notwithstanding Secretary Shultz's belief that there is little relationship between the wheat deal and these price rises because it looms very small, I contend that psychologically the wheat sale had an impact enormously beyond its dollar value.

I attended a meeting recently of bakers, who have an interest in low wheat prices, and a Department of Agriculture representative made this observation: "The Russian grain deal was the greatest thing which ever happened in this country because it taught us that we were on a cheap food policy too long." I will hope that the new economic coordinating instrument announced by President Ford has the capability for dampening enthusiasm of this character in the future.

I believe the information is probably sound that on November 8th the Organization of American States will vote to drop its boycott of Cuba. I think it is important, because of the enormous inflation which has occurred in sugar prices and the impact of that on a significant segment

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of the U. S. economy, that policy makers be advised of the relationship of Cuba to world prices. More generally, we should see some thoughtful analysis of world sugar prices as a function of the amelioration of relationships between Castro and Western Hemisphere nations.

We should be alerted to any imminent or threatening bank failures in oil-consumer countries because some of the host governments describe these bank failures in less serious terms than we tend to.

There must also be a continuing review of the significance to the U. S. of the development of Siberian oil and gas. That continuous alert must be especially sensitive to questions being raised about whether or not collaboration is in our interest.

I have been alerted to the possibility that the Middle Eastern states, especially Arab, may start to buy grains with their petro dollars or build large grain storage facilities because of two very good reasons--grain may be more useful for economic and political warfare and it may be their conclusion that such investments are safer than currencies. We ought, therefore, to be especially sensitive to any abnormal purchases of grain.

(Note: The Chairman asked Board member George Shultz to comment on Mr. Cherne's remarks, and he did so as follows: "Well, I think it's a very far-reaching, far-ranging report. I don't know quite where to break into it other than to say that I think the development of our passion for economic intelligence, figuring out how to use it, is very important. A lot of strides have been made and I think Leo's comments were just full of illustrations of why that's so.")

\* \* \*

Mr. Cherne was asked by other Board members to elaborate on the problems generated by the oil situation. In response, he made the following remarks on 4 October 1974 at the beginning of the second day of Board meetings.

The magnitude of the problem created by oil price rises can be seen if we just take the United States as a modest illustration. Last year we paid \$8.5 billion for Arab oil. This year the estimated sum is \$25.2 billion. At the Economic Summit conference some of the most significant observations on the subject of oil were made by [ ] an oil consultant, knows the economics of the industry and, I am told,

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has spent some time on this subject with the Secretary of State. His basic conclusion is that the most dangerous single threat to worldwide economic stability in 1975 and thereafter will be the disruptive impact of the oil price explosion on importers' and exporters' balance of payments.

The readjustments required are too rapid and huge to establish financial market mechanisms. Nor can recycling be undertaken by the United States and a few other major importing economies alone. OPEC governments must be invited to share this responsibility and [ ] takes the position that if the initiatives involving the OPEC countries are not made quickly, there is literally no possibility of their being involved later because their perceptions will change as they come to fully understand the changed power structure which they have brought about. STAT

Crude oil prices quadrupled between last October and last January. Since then there has really been a quintupling now of oil prices. Some of it was accomplished directly by price, some of it by taxation. By January 1975, and this, I think, is most significant, OPEC intends to impose an inflation index on oil which apparently could add an estimated 12 to 15 billion to the 1975 oil bill even if the quantity of oil being imported remained the same. They have learned the lesson of inflation. Any effort by the oil-importing countries to cope with their financial problems through conservation or through the development of domestic energy resources would be frustrated if the Arab countries do as they say. There have been a number of statements which suggest that the Arab nations--especially Saudi Arabia--desire to be reasonable. However, Saudi Arabia not only went along with price increases, but in a couple of cases proved to be more aggressive in certain of the price and production reduction measures than the other states. The Kuwaiti oil minister has said, and I quote: "If prices are subject to the law of supply and demand, then we shall reduce the supply in order to increase the demand for it. The crude will remain in the ground for the future."

We should bear in mind that the notion of cooperative activity, of helping the unfortunate, is alien to the Arab culture. Our hopes for cooperation from OAPEC should not obscure this historical reality.

All of this is emerging from a situation in a year in which 100 to 110 billion dollars of reserves from importing countries will be going to the producing countries. By 1980 the World Bank estimates that \$650 billion will have gone to the producing countries. There are no such reserves. I would also note a comment made at the Economic Summit to the effect

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that whereas today there are \$240 billion of EURO dollars on deposit with overseas banks, only five years ago there were \$40 billion. Today's levels are as great as all of the dollars on deposit in U.S. domestic banks. I just emphasize that to give some indication of the magnitude of this situation.

OECD members, fortunately, have formally agreed not to resort to restrictive trade practices and not to start rampant economic nationalism as a means of coping with the oil-related balance of payments deficits. But this agreement has a one-year life-span.

For oil-importing countries as a group, therefore, oil trade deficits can be met only by exports to oil-producing countries or increased domestic production. There simply is not much more the oil producers can import that we have got to sell them. There is no alternative to debt, and unfortunately the debt among those who cannot pay will be larger than among those who can pay.

[ ] the United States and the other importers should approach the three major producing countries of the Persian Gulf--Saudi Arabia, Iran and Kuwait--to present the importers' position as it emerges from their own assessment. The longer we delay such an approach the more we risk that OPEC's position will become irretrievably frozen. In turn, the present revenue flow will result in a massive accumulation of foreign reserves. Once that accumulation occurs, the producing countries would be much less inclined to listen to the importing countries and to agree to adjustments. [ ] realistic enough to say the initiatives might fail and that producing countries might still pursue a policy of pricing that would jeopardize not only the economic, political and strategic well-being of the oil-importing countries but ultimately their own survival. STAT

The economically strongest oil-importing countries--[ ] identifies those as the U.S. and Germany--not Japan--which would obviously attract most of the investment of the surplus funds and trade of the oil-producing countries, might consider how to limit the inflow of such funds to a level not exceeding the deficit of their own oil balance of trade--and they have nowhere else to go to invest their capital. In short, he is recommending a profound difference from normal U.S. or German practices. STAT

This kind of tactic would involve incredibly complex issues of monetary and trade policies, further complicated by the existence of the EURO currency market. Here is a significant element for the intelligence

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community: Petro dollars are not easy to identify and many financial intermediaries have vested interests in assisting this anonymity. Any such control or assignment of responsibility for the acquisition of information would be hard indeed to administer. It is advisable that these alternatives be subjected to the most intensive study which must also address the legal impediment to obtaining this information. This ought to be undertaken right now so that when the President asks for his alternatives, he can be authoritatively advised. I am hopeful he will ask for a stratagem at some point soon.

#### NEXT STEPS

##### What might be done to sharpen the focus?

I have not reported on the Economic Summit conference except in the most general terms, but I do believe there are implications for the intelligence community which emerge from that significant undertaking.

I would preface my closing remark by describing a pre-Economic Summit meeting I had with Mr. L. William Seidman, the President's economic policy coordinator. I tried to convey to him the work of the PFIAB in this area, particularly the pioneering role of its December 1971 report. I indicated that the intelligence community had been responding to the growing needs of policy makers. I did not indicate that there are certain areas where there is still less than is required. I stressed the fact that national goals within the Executive Branch sometimes appear in conflict with each other, and that, as perhaps never before, there is an urgent need for such questions and any such conflicts to be resolved at a high policy level. Since this meeting with Mr. Seidman, President Ford announced establishment of the Economic Policy Board. That Board will, hopefully, among its other responsibilities, successfully meet this need as well.

I want to close with the observation that a post Economic Summit meeting by knowledgeable, senior government officials to appraise the role the intelligence community can play in meeting the triple problems of inflation, depression, or international economic disorganization, might be invaluable. Before the intelligence community can hope to adequately respond to these critical needs, it is first necessary to thoroughly understand what it is the policy makers require, how intelligence can contribute and at what cost, and what other considerations bear on the role that is expected. We should follow through by discussing this possibility with the DCI and leading economic policy makers.

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